



FI Ref. 15-3226

Finansinspektionen
Box 7821
SE-103 97 Stockholm
[Brunnsgatan 3]
Tel +46 8 787 80 00
Fax +46 8 24 13 35
finansinspektionen@fi.se
www.fi.se

Decision regarding the countercyclical buffer rate

Finansinspektionen (the Swedish Financial Supervisory Authority) has decided not to amend Finansinspektionen's Regulations (FFFS 2014:33) regarding the countercyclical buffer rate. The buffer rate of 1 per cent, which is specified in the regulations, shall thus continue to apply.

Background

According to Chapter 7, section 1 of the Capital Buffers Act (2014:966) ('the Buffer Act'), Finansinspektionen shall set a countercyclical buffer guide¹ and a countercyclical buffer rate for each quarter. Finansinspektionen decided on 8 September 2014 to issue new regulations concerning a countercyclical buffer rate: Finansinspektionen's Regulations (FFFS 2014:33) regarding the countercyclical buffer rate.² These regulations meant that the countercyclical capital buffer for Sweden was activated. According to the regulations, the countercyclical buffer rate shall be 1 per cent and be applied as of 13 September 2015. On 8 December 2014, Finansinspektionen made a new quarterly decision setting out that the buffer rate of 1 per cent shall continue to apply. In the motivation for the decision³, it is set out that the countercyclical buffer guide was then set at 1.65 per cent.

Finansinspektionen's assessment

The purpose of the countercyclical capital buffer is to strengthen the resilience of banks and ensure that the banking system as a whole has sufficient capital to sustain the flow of credit to households and corporations in situations when shocks to the financial system could cause a credit crunch. The countercyclical buffer is to be built up when financial imbalances risk building up and causing

¹ The buffer guide constitutes the point of departure for Finansinspektionen's assessment of the size of the countercyclical buffer rate.

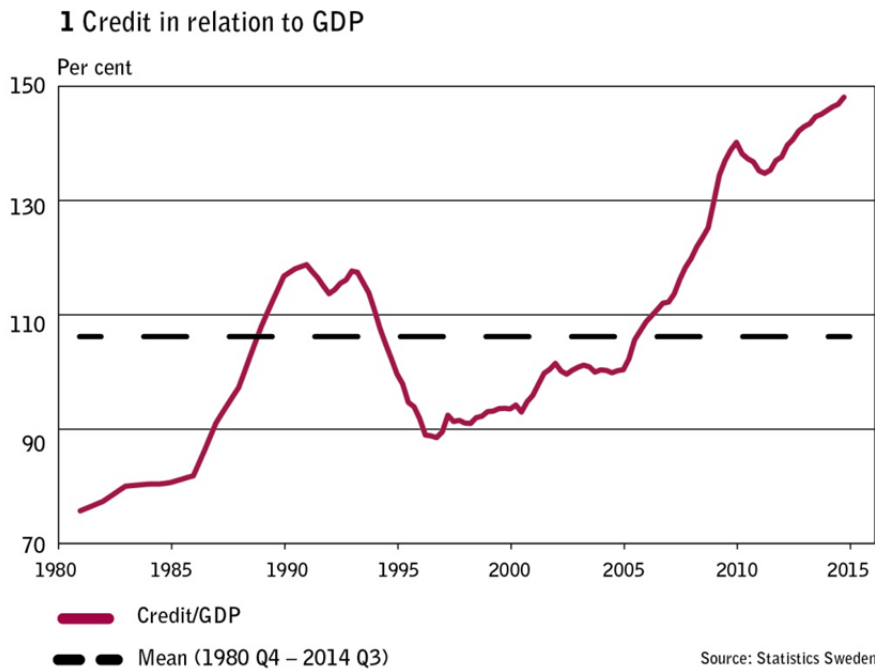
² FI (2014), *Regulations regarding the countercyclical buffer rate*. Published on fi.se on 10 September 2014, FI Ref. 14-7010.

³ FI (2014), *Decision regarding the countercyclical buffer rate*. Published on fi.se on 10 December 2014, FI Ref. 14-16989.

systemic risks. In the event of a recession or major losses incurred by the banks, lending can be tightened. In such a situation, the buffer requirement may be reduced to prevent tighter lending from magnifying the economic downturn.

Finansinspektionen sets the countercyclical buffer rate for Sweden on the basis of a qualitative assessment that takes quantitative factors into consideration. *The buffer guide* is an important, but not decisive, factor in this assessment. Consideration shall also be given to other quantitative variables that are relevant for assessing the cyclical systemic risks.

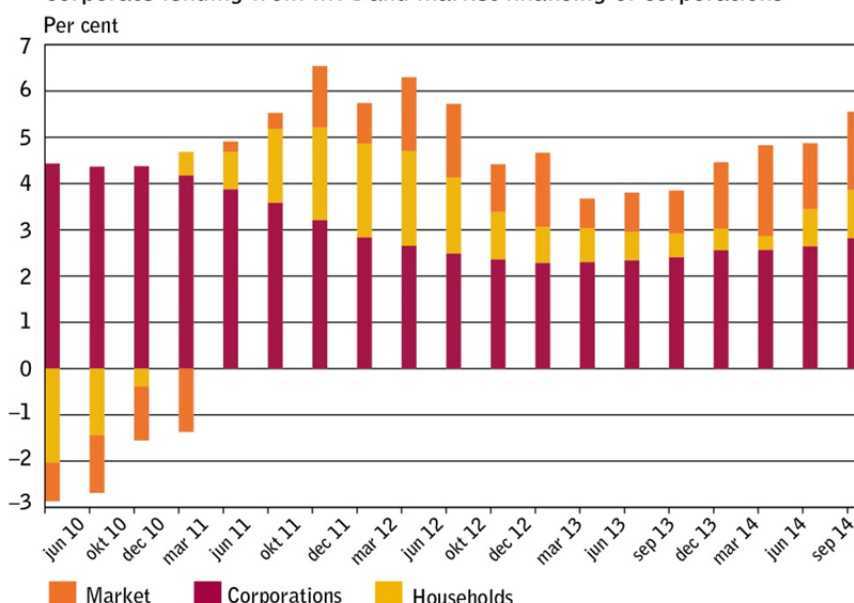
The point of departure for Finansinspektionen’s assessment of cyclical systemic risks is the ‘credit gap’, which is a measure of the deviation of the ratio of credit-to-GDP from its long-term trend.⁴ Total household and corporate lending in Sweden rose faster than GDP in the 2000s. However, growth in household and corporate credit has slowed down since the financial crisis. Despite this, total household and corporate lending is still at a historically high level and continues to rise (see Diagram 1).



The annualised growth rates for lending to the private non-financial sector rose somewhat in the third quarter of 2014. This is shown in Diagram 2, which also shows how much household and corporate lending from monetary financial institutions (MFI) and the market financing of corporations contribute to total credit growth.

⁴ For Sweden, the measure of total credit to the private sector covers all corporate and household lending issued through monetary financial institutions (MFI) and the total market financing of corporations. The market financing of corporations has been defined as the value of all outstanding corporate bonds and certificates traded on the fixed-income market.

2 Growth rates in lending broken down by contributions from households, corporate lending from MFI and market financing of corporations



Source: Statistics Sweden

Lending continues to grow faster than GDP, and the annual growth rate for both household lending and corporate lending still shows an upward trend (see Table 1). The growth rate for household lending has increased and is currently at 5.4 per cent. Corporate lending from financial institutions continues to show signs of a recovery and has risen 3 per cent year-on-year compared with the same quarter of the preceding year. The market financing of corporations continues to rise rapidly, and is hence an increasingly important source of financing for the corporations, besides the monetary financial institutions. Rising total corporate lending probably reflects a stronger investment cycle.

1 Growth rates in lending to households and corporations (excluding and including the market financing of corporations)

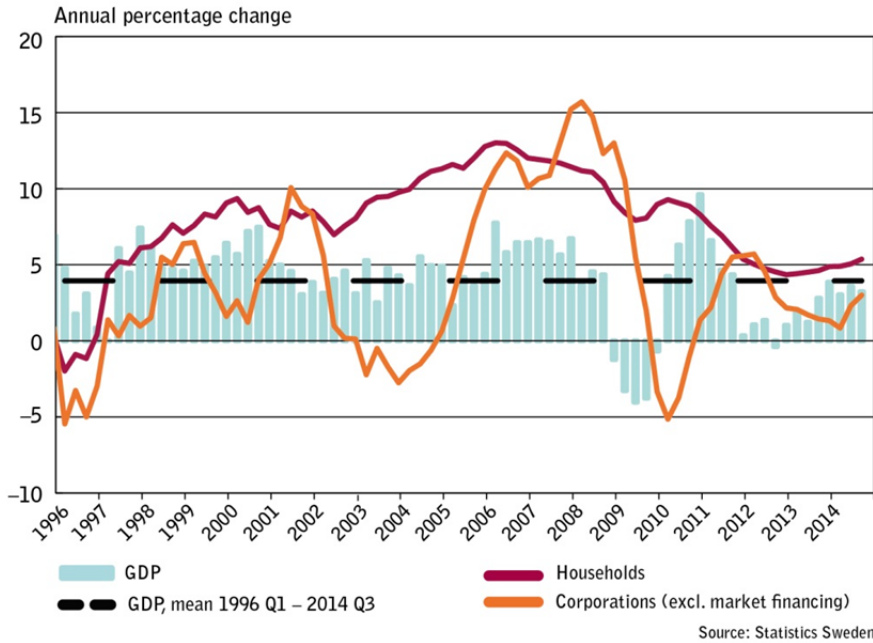
Annual percentage change

	Households (MFI)	Corporations (MFI)	Corporations (market)	Corporations (MFI+market)	Total credit
2013 Q3	4.6	1.4	7.5	3.0	3.8
2013 Q4	4.9	1.3	11.7	4.0	4.5
2014 Q1	4.9	0.8	15.8	4.8	4.8
2014 Q2	5.1	2.3	11.1	4.7	4.9
2014 Q3	5.4	3.0	13.2	5.8	5.5

Source: Statistics Sweden

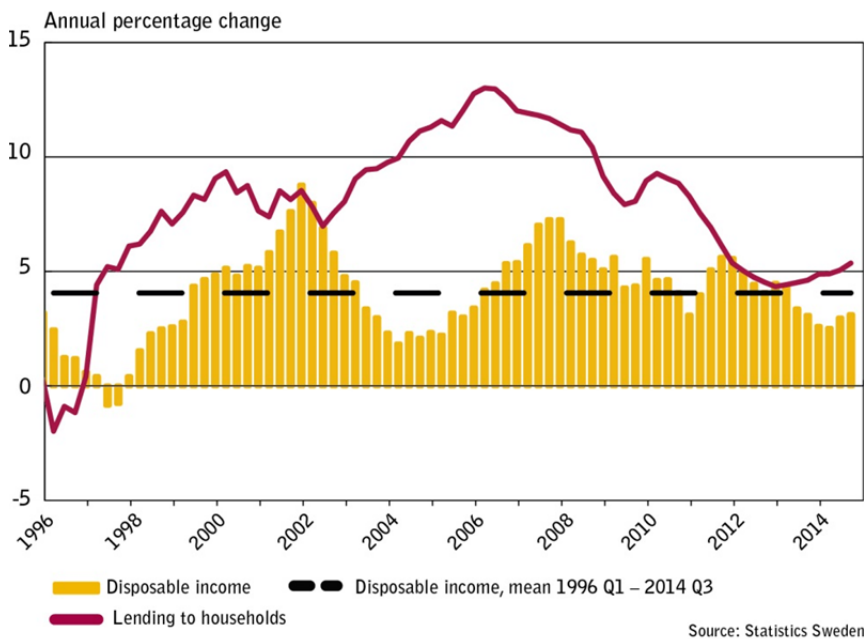
On the whole, household debt is still growing faster than GDP, while the growth rate for corporate lending from financial institutions is starting to approach nominal GDP growth (see Diagram 3).

3 Growth rate in lending to households and corporations and nominal GDP growth



Both household credits and disposable income grew in the third quarter of 2014, but lending to households still grew faster than disposable income (see Diagram 4). This may be because house prices, which drive household lending, have continued to increase faster than household disposable income in the past few quarters. However, disposable income continues to increase at a healthy rate, close to the historical average, not least because of the low interest rate environment.

4 Growth rate in lending to households and nominal disposable income



When setting the buffer rate, it is important to also consider other measures taken by Finansinspektionen to manage systemic risk. Finansinspektionen has already taken a series of measures which, combined, aim to both promote consumer protection and increase the banks' resilience and ability to cope with systemic risks which may be linked to household indebtedness.⁵ As part of this work, Finansinspektionen now also intends to introduce an amortisation requirement for new mortgages.⁶ This is because heavily mortgaged households are sensitive to financial pressures and can pose a macroeconomic risk. An amortisation requirement bolsters household resilience to financial pressures and reduces the macroeconomic risk. The proposed regulation entails an obligation for new mortgage holders to pay their mortgages down to a 50 per cent loan-to-value ratio. The measure is assessed to have a curbing effect on household demand for mortgages, which account for most household credits. The amortisation requirement is intended to start to apply from 1 August 2015.

Buffer guide and other quantitative factors

The buffer guide constitutes the point of departure for Finansinspektionen's assessment of the size of the countercyclical buffer rate in Sweden. There is, however, no mechanical link between the buffer guide and the level of the countercyclical buffer. Decisions on the countercyclical buffer rate are based on both quantitative and qualitative assessments of the sustainability of the credit development and the level of systemic risks. For this reason, Finansinspektionen also takes into account other relevant variables that could signal the build-up or slowdown of cyclical systemic risk, and performs its own qualitative assessments.

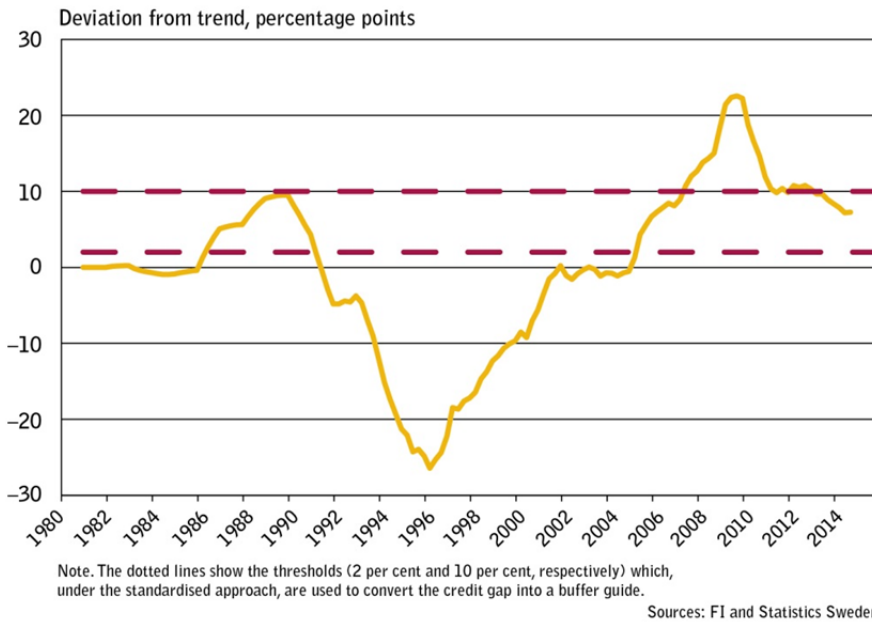
Finansinspektionen calculates the countercyclical buffer guide in accordance with the Basel Committee's standardised approach, which is based on the credit gap, i.e. the deviation of the ratio of credit-to-GDP from its long-term trend.⁷ According to the standardised approach, the credit gap is 7.3 per cent (see Diagram 5).

⁵ In 2010 Finansinspektionen introduced a mortgage cap of 85 per cent, entailing that households may not borrow more than 85 per cent of the value of the home collateralised by the home. In addition, in 2013 Finansinspektionen introduced a risk weight floor for Swedish mortgages of 15 per cent for the banks that use the internal ratings-based approach to calculate the risk weights for their credit exposures. This risk weight floor was increased to 25 per cent in 2014.

⁶ See proposal for new regulations requiring the amortization of new mortgages, published on fi.se on 11 March 2015, <http://www.fi.se/Folder-EN/Startpage/Press/Press-releases/Listan/Amortisation-requirement-for-new-mortgages/>.

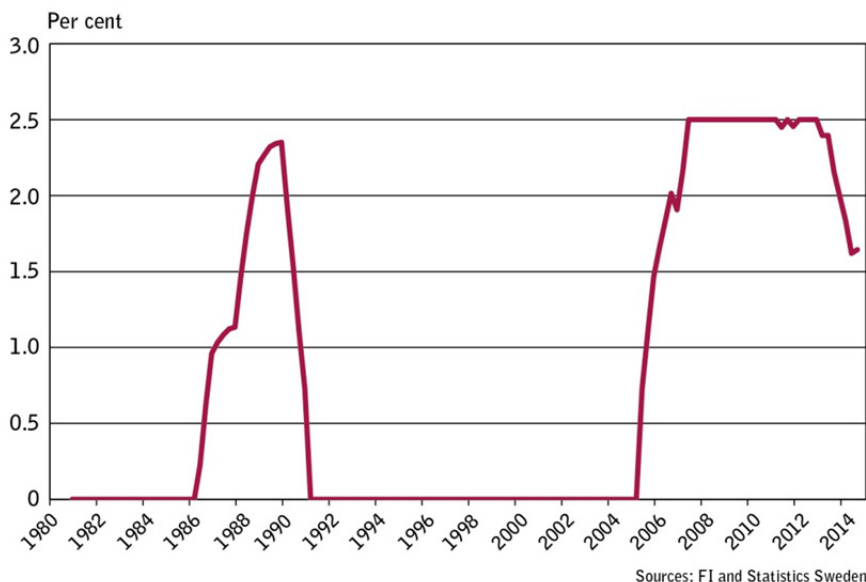
⁷ For more information about the standardised approach, see FI (2014), *Regulations regarding the countercyclical buffer rate*. Published on fi.se on 10 September 2014, FI Ref. 14-7010.

5 Credit gap according to the standardised approach



The credit gap is converted into a buffer guide according to a quantitative rule that specifies how the credit gap and buffer guide are to stand in relation to each other. A credit gap of 7.3 per cent means that the countercyclical buffer guide in Sweden is 1.65 per cent for the third quarter of 2014 (see Diagram 6).

6 Buffer level according to standardised approach



Finansinspektionen has also chosen to monitor a number of indicators that, in addition to the credit gap, are considered to be relevant to Sweden when setting the countercyclical buffer rate. These include various measures of credit

developments, house prices in relation to disposable income, current account and financial savings in the public sector as a share of GDP, bank capital levels, the interest-to-income ratio of households, and developments in real equity prices.⁸

A description of the development in lending for the third quarter of 2014 was provided above. The picture given by the other indicators for the same period is that the situation has not changed appreciably compared with the second quarter of the year. It can be noted that the ratio between house prices and disposable income has increased somewhat further compared with the previous quarter. Although household disposable income has increased by around 3 per cent year-on-year, house prices are increasing faster. The annual growth rate for house prices was around 8 per cent for the third quarter of 2014. At the same time, the interest-to-income ratio of households remains very low, and because of the low interest rates, interest expenses constitute a shrinking burden on household finances.

The Swedish current account balance decreased somewhat in 2014, but is still positive. Currently, there do not seem to be any imbalances in the Swedish economy as a whole. In addition, the capital strength of the banks remains sound and improved in the third quarter. The Swedish banks are well capitalised and meet the imposed capital requirements by a comfortable margin.⁹ This is a clear indication that resilience in the Swedish banking sector is strong.

Overall assessment

Total lending to the private non-financial sector continued to rise somewhat in the third quarter of 2014. In particular, the growth rate for corporate lending from both MFIs and through market financing increased from the same quarter of the previous year. The development in lending from both of these sources of financing is a reason for the total growth rate for corporate lending, for the first time in a long time, being somewhat higher than the growth rate for household lending. Since corporate lending has been at a low level for a relatively long period of time, this development is not considered problematic.

Where household credits are concerned, they are growing slightly faster than nominal GDP growth and disposable income. Although growth rates for household and corporate lending are somewhat higher than GDP growth, they are still deemed to be at a reasonable level. Neither are there signs of any imbalances in terms of the development in the other quantitative indicators that form the basis for the assessment of the overall risk landscape. In addition,

⁸ Appendix 1 provides diagrams of the development for these indicators.

⁹ FI (2015), *The Swedish banks' capital requirements, fourth quarter 2014*. Published on fi.se on 19 February 2015, FI ref. 14-16254.

Finansinspektionen continues to work in managing the risks in household indebtedness by introducing an amortisation requirement for mortgages.

On the whole, Finansinspektionen's analysis of the latest developments does not suggest a further build-up of financial imbalances. In light of the development in the various indicators, as well as implemented and planned measures, the countercyclical buffer rate shall continue to be 1 per cent.

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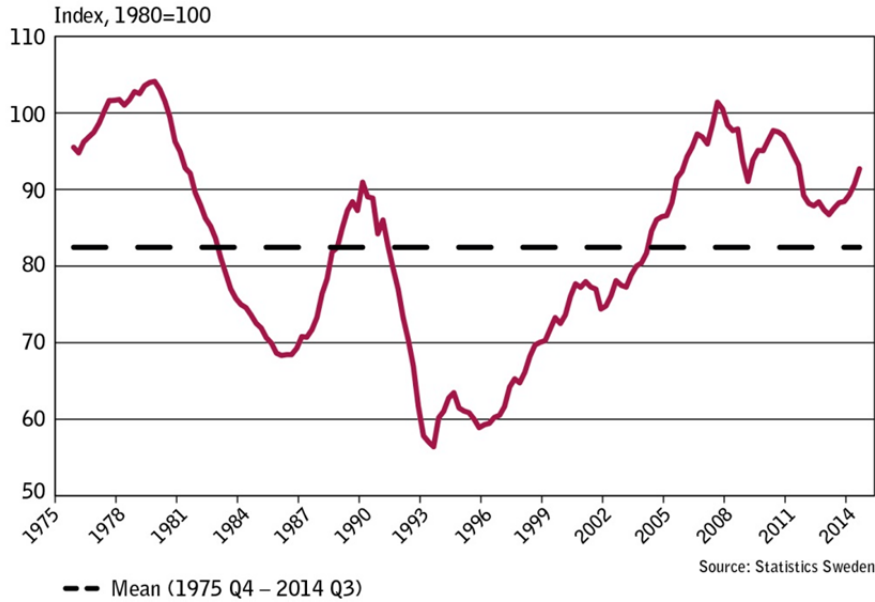
Sven-Erik Österberg
Chair of the Board

Matilda Gjirja
Senior Analyst

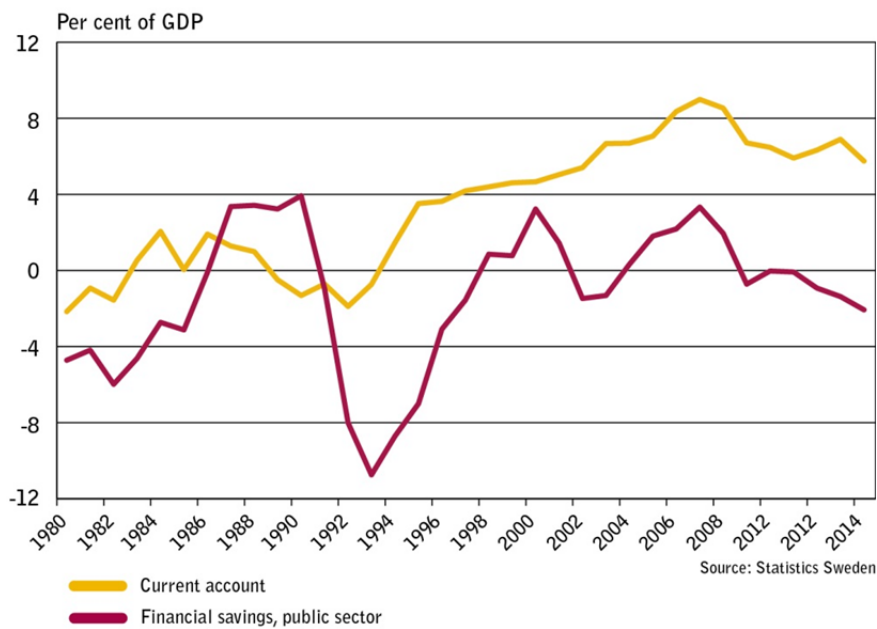
A decision in this matter was made by the Board of Directors of Finansinspektionen (Sven-Erik Österberg, Chair, Hans Nyman, Gustaf Sjöberg, Kristina Ståhl and Martin Andersson, Director General) following a presentation by Matilda Gjirja (Senior Analyst). Per Håkansson (Chief Legal Counsel) and Henrik Braconier (Chief Economist) also participated in the final procedure.

Appendix 1

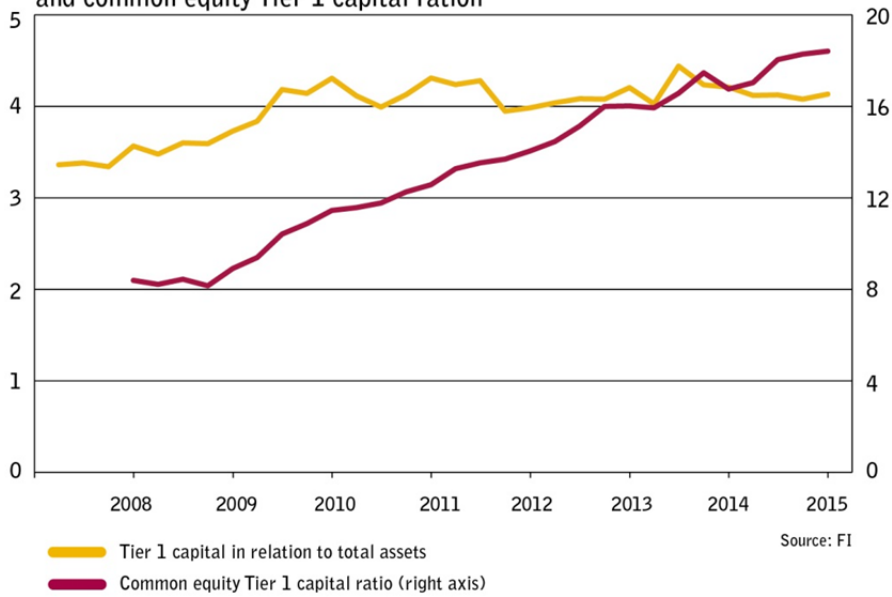
B 1.1 House prices in relation to disposable income



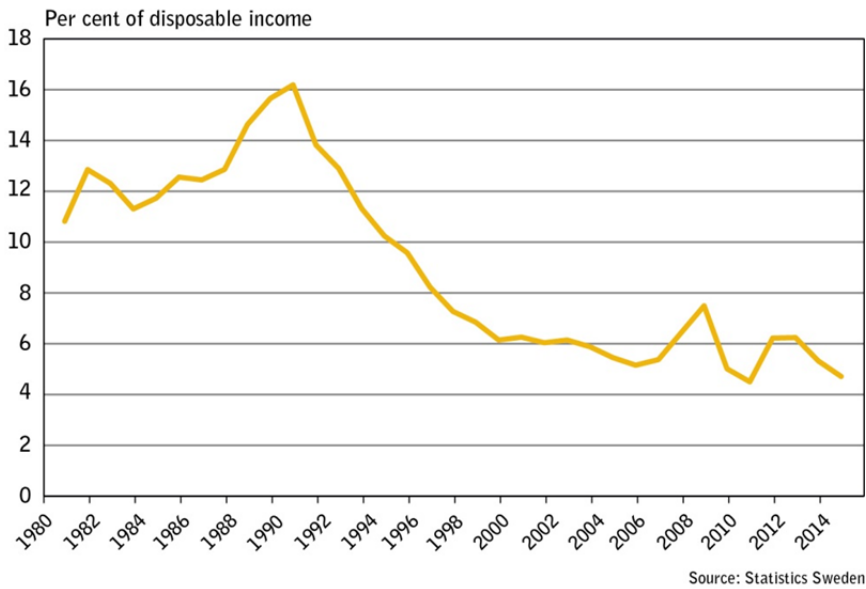
B 1.2 Current account and financial saving in the public sector



B 1.3 Tier 1 capital in relation to total assets and common equity Tier 1 capital ration



B 1.4 Interest rate ratio of households



B 1.5 Real equity prices



Note: Real equity prices have been calculated by deflating the OMX by CPIF.

Source: Statistics Sweden and Reuters Ecowin